

APR 1 1945
CLERK

No. 1125

In the Supreme Court of the United States

OCTOBER TERM, 1944

THE UNITED STATES OF AMERICA AND FEDERAL
COMMUNICATIONS COMMISSION, APPELLANTS

v.

NEW YORK TELEPHONE COMPANY

APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

STATEMENT AS TO JURISDICTION

**United States District Court, Southern
District of New York**

Civil Action 24-211

NEW-YORK TELEPHONE COMPANY, PLAINTIFF

v.

**UNITED STATES OF AMERICA AND FEDERAL COM-
MUNICATIONS COMMISSION, DEFENDANTS**

STATEMENT AS TO JURISDICTION

This suit was instituted in the District Court of the United States for the Southern District of New York under the provisions of the Urgent Deficiencies Act as extended by Section 402 (a) of the Communications Act of 1934 (47 U. S. C. Section 402 (a)) to enjoin, set aside, annul and suspend an order of the Federal Communications Commission denominated Commission Order in Docket No. 6329 "In the Matter of the New York Telephone Company, Accounting," dated December 14, 1943, requiring the New York Telephone Company to make certain specified adjustments in its books of account in order to eliminate from its books certain write-ups in property values, presently reflected in the books of the company, found

(1)

by the Commission to be purely fictitious write-ups resulting from transactions between a parent company and its controlled affiliate. Defendants filed a motion for summary judgment, together with the supporting affidavit of Charles R. Denny, and moved that the complaint of the New York Telephone Company be dismissed. The motion for summary judgment was argued before a three-judge district court convened pursuant to the provisions of the Urgent Deficiencies Appropriation Act of October 22, 1913, Chapter 32 (38 Stat. 220; 28 U. S. C. A. Section 47) and it was stipulated among the parties that final judgment might be entered as on a final hearing upon the decision of the Court with respect to the motion for summary judgment.

By decision, dated August 24, 1944, the Court denied the action for summary judgment and on January 2, 1945, a final judgment and order in the case were entered permanently enjoining, setting aside, suspending, and annulling the order of the Federal Communications Commission and permanently restraining and enjoining its enforcement.

Pursuant to Rule 12 of the Supreme Court of the United States, the petitioner, in support of the jurisdiction of the Supreme Court to review the judgment, order, and decree in question, respectfully represents:

STATUTORY PROVISIONS BELIEVED TO SUSTAIN
JURISDICTION

The statutory provisions believed to sustain the jurisdiction of this appeal are:

Section 402 (a) of the Communications Act of 1934, 47 U. S. C. Sec. 402 (a), which makes the provisions of the Urgent Deficiencies Act applicable to this suit; and

The Urgent Deficiencies Act of October 22, 1913, c. 32; 38 Stat. 219, 220; 28 U. S. C. Secs. 47, 47a, which provides for direct appeal to the Supreme Court of the United States from judgments or decrees of three-judge courts constituted under the Act.

II

STATUTE OF THE UNITED STATES AND ORDER PROMULGATED THEREUNDER, THE VALIDITY OF WHICH IS INVOLVED

The pertinent provisions of the Communications Act of 1934 are:

SEC. 213. (c) The Commission may at any time require any such carrier to file with the Commission a statement showing the original cost at the time of dedication to the public use of all or of any part of the property owned or used by said carrier. For the showing of such original cost said property shall be classified, and the original cost shall be defined, in such manner as the Commission may prescribe; and if any

part of such cost cannot be determined from accounting or other records, the portion of the property for which such cost cannot be determined shall be reported to the Commission; and, if the Commission shall so direct, the original cost thereof shall be estimated in such manner as the Commission may prescribe. If the carrier owning the property at the time such original cost is reported shall have paid more or less than the original cost to acquire the same, the amount of such cost of acquisition, and any facts which the Commission may require in connection therewith, shall be reported with such original cost. The report made by a carrier under this paragraph shall show the source or sources from which the original cost reported was obtained, and such other information as to the manner in which the report was prepared, as the Commission shall require.

SEC. 220. (a). The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys:

SEC. 220. (c). The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or

hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

SEC. 220. (g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

SEC. 402. (a) The provisions of the Act of October 22, 1913 (38 Stat. 219), relating to the enforcing or setting aside of the or-

ders of the Interstate Commerce Commission, are hereby made applicable to suits to enforce, enjoin, set aside, annul, or suspend any order of the Commission under this Act (except any order of the Commission granting or refusing an application for a construction permit for a radio station, or for a radio station license, or for renewal of an existing radio station license, or for modification of an existing radio station license, or suspending a radio operator's license) and such suits are hereby authorized to be brought as provided in that Act.

SEC. 604. (a) All orders, determinations, rules, regulations, permits, contracts, licenses, and privileges which have been issued, made, or granted by the Interstate Commerce Commission, the Federal Radio Commission, or the Postmaster General, under any provision of law repealed or amended by this Act or in the exercise of duties, powers, or functions transferred to the Commission by this Act, and which are in effect at the time this section takes effect, shall continue in effect until modified, terminated, superseded, or repealed by the Commission or by operation of law.

The Federal Communications Commission, purporting to act under the authority of the Communications Act of 1934, ch. 652, 46 Stat. 1064, as amended, 47 U. S. C. Secs. 151-609, made the order hereinafter set forth.

BEFORE THE FEDERAL COMMUNICATIONS
COMMISSION

WASHINGTON, D. C.

Docket No. 6329

P-30

IN THE MATTER OF NEW YORK TELEPHONE
COMPANY, ACCOUNTING

ORDER

At a session of the Federal Communications Commission held at its offices in Washington, D. C., on the 14th day of December, 1943;

The Commission, having under consideration the record of the proceedings herein, including its Proposed Report herein adopted June 22, 1943, the exceptions and arguments with respect thereto; and having this day adopted its Report herein;

IT IS ORDERED, That the Report of the Commission adopted this day in this proceeding BE, AND IT IS HEREBY MADE A PART HEREOF BY REFERENCE:

IT IS FURTHER ORDERED, That:

(1) The New York Telephone Company shall charge (debit) the amount of \$4,166,510.57 to its Account 413, "Miscellaneous Debits to Surplus";

(2) The New York Telephone Company shall concurrently with such charge to Account 413, make entries (a) to eliminate, by appropriate entries to its Account 100.4,

"Telephone Plant Acquisition Adjustment"; the amounts presently included in that account, associated with the New York Telephone Company's acquisition from the American Telephone and Telegraph Company on November 1, 1925, September 1, 1926, and December 31, 1928; (b) to eliminate the amounts presently included in Account 172, "Amortization Reserve", associated with such acquisitions, with contra entries to Account 171, "Depreciation Reserve"; (c) to adjust the balances in Account 100.1, "Telephone Plant in Service", and the related primary plant Account 231, "Station Apparatus", to reflect the original cost of the surviving telephone instruments acquired by the New York Telephone Company from the American Telephone and Telegraph Company on December 31, 1927, by debits to those accounts in the amount of the difference between such original cost and the surviving amounts recorded in such accounts; and (d) to adjust the balance in Account 171, to reflect appropriately the elimination of the inter-company profit or write-up of \$4,166,510.57 resulting from the accounting performed by the New York Telephone Company at the time of and during the period since such acquisition, with respect to and as a result of such acquisitions, by credits to that account equal to the difference between the amounts debited to Account 100.1 and Account 413, and the amounts credited to Account 100.4;

(3) The New York Telephone Company shall correct its books and records as of December 31, 1941, by placing thereon the following entries:

Entry No. 1	Debit	Credit
100.1 Telephone Plant in Service (Account 231, Station Apparatus)-----	\$194,886.97	
100.4 Telephone Plant Acquisition Adjustment-----		\$481,439.60
171 Depreciation Reserve-----		3,879,957.94
413 Miscellaneous Debits to Surplus-----	4,166,510.57	

This entry made in accordance with the order of the Federal Communications Commission dated December 14, 1943, in Docket No. 6329.

Entry No. 2	Debit	Credit
171 Depreciation Reserve-----		\$333,559.21
172 Amortization Reserve-----	\$333,559.21	

This entry made in accordance with the order of the Federal Communications Commission dated December 14, 1943, in Docket No. 6329.

(4) The New York Telephone Company shall make any necessary entries to adjust entries reflecting transactions subsequent to December 31, 1941, and to adjust between Account 231, "Station apparatus," and Account 122, "Material and Supplies," as may be required to be consistent with the entries required by the above provisions of this order.

(5) All charges which the New York Telephone Company has made to its operating expense accounts for the purpose of, or in conjunction with, amortizing or otherwise disposing of all amounts included in,

its Account 100.4 other than those included therein with respect to the toll property acquisitions dated November 1, 1925, September 1, 1926, and December 31, 1928, shall continue to be suspended, and respondent shall cause and desist from making any such charge to its operating expense accounts, pending submission of proof by respondent of the propriety and reasonableness of such charges, and the specific direction, authorization, or approval of the Commission:

IT IS FURTHER ORDERED, That the investigation instituted by the Commission's order of June 16, 1942, herein, to determine whether respondent or any of its officers or directors has violated certain of the Commission's accounting rules and regulations BE, AND IT IS HEREBY TERMINATED AND DISMISSED;

IT IS FURTHER ORDERED, That the New York Telephone Company shall within 60 days from the service of this order submit verified proof that the journal entries required herein have been made.

IT IS FURTHER ORDERED, That the New York Telephone Company shall within 40 days from the service of this order notify this Commission in writing whether this order and all of its terms and requirements are accepted and will be obeyed.

By the Commission,

(Sgd.) T. J. SLOWIE,

T. J. Slowie,

Secretary.

III

DATE OF JUDGMENT OR DECREE AND DATE OF
APPLICATION FOR APPEAL

The date of the decree sought to be reviewed is January 2, 1945, on which day the said decree was made and entered.

The application for this appeal was made on February —, 1945.

IV

NATURE OF THE CASE

In 1925, 1926, and 1928, American Telephone and Telegraph Company transferred to plaintiff, New York Telephone Company, which the American Telephone and Telegraph Company controlled through ownership of 100 percent of its common stock, certain toll line properties, and in 1927 it also transferred to plaintiff certain parts of the telephone instruments theretofore owned by American Telephone and Telegraph Company. The transfers did not involve any change in the physical character of the property, in the service rendered to the public, or the use of the plant in rendering the service. Before the transfers the property was carried on the books of American Telephone and Telegraph Company at \$13,269,567.47 with related depreciation and amortization reserves of \$4,801,397.66, or a net book cost of \$8,468,169.81. The "prices" assigned to the properties for the purpose of the transfer totaled

\$12,634,680.38, or a "profit" to American Telephone and Telegraph Company of \$4,166,510.57. The price was allegedly equal to or less than the estimated reproduction cost new of the property at that time less existing depreciation.

Plaintiff recorded the transfers on its books by entering in its plant accounts the "prices" assigned to each transfer, which were thus the "book cost" to it. No amount was entered with respect to this property in its depreciation or amortization reserve accounts. Thereafter, there was credited annually to the depreciation reserve a certain percentage of the "book cost" of the property as so recorded on plaintiff's books. This percentage was the depreciation rate which had theretofore been determined (as revised from time to time) to be applicable to the several classes of telephone plant accounts in which the transfers in question were recorded.

From time to time some of the transferred property was retired by the plaintiff. This was accomplished by crediting the plant accounts with the entire book cost to plaintiff of such property and by debiting the same amounts (with allowance for salvage) to its depreciation or amortization reserve accounts.

In July 1934 jurisdiction with respect to plaintiff's accounting was transferred from the Interstate Commerce Commission to the Federal Communications Commission. On January 1, 1937 fol-

lowing the decision of the Supreme Court in *American Telephone and Telegraph Company v. United States*, 299 U. S. 232, the Commission's Uniform System of Accounts for Class A and Class B Telephone Companies became effective and its provisions are applicable to plaintiff as a Class A telephone company. By the provisions of this Uniform System of Accounts plaintiff was required to reclassify the amounts recorded in its existing accounts to conform with the original cost provisions of the Commission's Uniform System of Accounts. In purported compliance plaintiff transferred a small amount, as pertaining to certain of the above transfers of property, from Account 100.1, "Telephone plant in service" to Account 100.4, "Telephone plant acquisition adjustment." In this process of reclassification, no amount was credited to Account 171, "Depreciation reserve."

In June 1942 the Commission instituted an investigation into the accounting performed and the accounts, records, and memoranda kept by plaintiff with respect to the transfers in question. Plaintiff was ordered to show cause why the amount of \$4,166,510.57 should not be charged to Account 413, "Miscellaneous debits to surplus." After public hearings and argument, the Commission on December 14, 1943, issued its report and order. The Commission found that the accounting performed by the plaintiff with respect to the

four inter-company transfers resulted in a purely inflationary write-up of plaintiff's accounts. The Commission further found that such inflationary write-up was still present in plaintiff's accounts despite the physical retirement of some of the property. As to the surviving property the inflation was either in the plant or depreciation reserve accounts; as to the retired property the inflation was present in the form of a deficiency in the depreciation reserve account. Accordingly, the Commission directed plaintiff to charge the entire amount of \$4,166,510.57 to surplus with appropriate concurrent entries.

On February 11, 1944, New York Telephone Company, pursuant to the provisions of the Urgent Deficiencies Act as extended by section 402 (a) of the Communications Act (47 U. S. C. sec. 402 (a)), filed a suit in the United States District Court for the Southern District of New York against the United States and the Federal Communications Commission to enjoin, set aside, annul, or suspend the Commission's order of December 14, 1943. On March 29, 1944, the United States and the Federal Communications Commission filed a motion for summary judgment together with the supporting affidavit of Charles R. Denny. In accordance with the procedure approved by the Supreme Court in *National Broadcasting Company, Inc. v. United States*, 319 U. S. 190, the record of the proceedings before the Commission

was attached to the affidavit and made a part thereof. It was stipulated among the parties that upon determination of the motion, final judgment might be entered as on a final hearing in favor of the party in whose favor the motion should be decided.

On August 24, 1944, the Court handed down its opinion denying the motion for summary judgment and on January 2, 1945, entered a final judgment and order permanently enjoining, setting aside, suspending, and annulling the order of the Commission. The Court held that the Commission's order violated the supplemental memorandum filed by the Government in *United States v. American Telephone & Telegraph Co.*, 299 U. S. 232. The court further held that the Commission's order was invalid because the accounting performed by the New York Telephone Company in connection with the transfers in question was in complete accord with the applicable rules and regulations of the Interstate Commerce Commission, and that since the entries were correct when made the Commission could not retroactively apply a new system to write down the plaintiff's surplus.

SUBSTANTIAL NATURE OF THE QUESTIONS INVOLVED

The questions raised upon this appeal are substantial:

(1) *The Supplemental Memorandum in the American Telephone and Telegraph case.*—The court in the instant case held that the order of the Commission violates the supplemental memorandum filed in *American Telephone and Telegraph Company v. United States*, 299 U. S. 232. This constitutes a serious misconstruction of both that supplemental memorandum and the opinion of this Court in that case. The supplemental memorandum and the opinion of the Court in the *American Telephone and Telegraph Company* case clearly recognize the right of the Commission to require carriers to write off their books as fictitious or paper increments the difference between original cost and so-called price resulting from transactions between a parent company and its controlled subsidiary.

(2) *Applicability of Accounting Regulation of the Interstate Commerce Commission.*—The court in the instant case held that the accounting performed by plaintiff was in complete accord with the rules of the Interstate Commerce Commission applicable when the transfers were made and that the Federal Communications Commission could not retroactively apply a new system. This over-

looks the provisions of Section 604 (a) of the Communications Act (47 U. S. C. Sec. 604 (a)) which specifically authorizes the Federal Communications Commission to modify, terminate, supersede or repeal rules or regulations of the Interstate Commerce Commission. This the Commission did when it adopted its Uniform System of Accounts. Upon the adoption of this system of accounts the Commission did not attempt to impose a penalty on plaintiff for its failure to keep its books in the past in accordance with the Federal Communications Commission's Uniform System of Accounts. What the Commission did was to require plaintiff to reclassify its accounts so that they would accurately reflect existing facts according to the Federal Communications Commission's System of Accounts. This requirement would apply not only to property which survived but also—and even plaintiff conceded this in its brief in the court below—as to retired property if the accounting performed with respect to the property in question had caused the balance in some other account not to conform to the facts. The question thus reduces itself to the simple question whether the accounting performed with respect to the retired property did result in a misstatement still reflected in some of the accounts when the Commission assumed jurisdiction.

The record is clear that there was such a misstatement. The depreciation of the property

which plaintiff acquired from A. T. & T. was accounted for by the plaintiff at annual rates which did not take into consideration the fact that the property was partly depreciated at the time of its acquisition, and was entered on its books at a figure which purported to reflect existing depreciation, with nothing being included in the depreciation or amortization reserves with respect to the property. As a result, when the property reached the end of its service life insufficient amounts had been accumulated in plaintiff's depreciation reserve to cover the cost of the property as carried in plaintiff's plant accounts. Thus, when the property in question was retired and plaintiff's book cost of the property was credited to plant account and the same amount was debited to depreciation reserve, plaintiff charged to the depreciation reserve more than had been credited thereto; the excess being at least as much as the amount of the write-up with respect to that property. This resulted in moving the inflation from the plant accounts to the depreciation reserve in the form of a deficiency in the reserve. Under this type of accounting the retirement of property could not possibly have removed any of the inflation which was introduced into the accounts when the transfers took place.

Plaintiff argued before the Commission and the court below that its depreciation reserve as a

whole has not been shown to be inadequate. Plaintiff's point seems to be that the mere fact that it debited its depreciation reserve with more than it had credited thereto is not controlling unless it can be shown that the depreciation reserve as a whole is inadequate. This is certainly a novel doctrine. What plaintiff is urging is that when the Commission discovers that there is inflation in plaintiff's accounts because of excessive debits in its depreciation reserve, the Commission is powerless to require plaintiff to eliminate this inflation unless the Commission can find that the depreciation reserve as a whole is inadequate. The composition of the depreciation reserve of a company whose operations are as extensive as those of plaintiff depends upon many complex and variable factors. If, as plaintiff suggests, the Commission may correct accounting mistakes which it finds with respect to that depreciation reserve only after it examines or reexamines anew in every case the overall adequacy of the depreciation reserve, the Commission would be hamstrung in the effective exercise of its accounting power. Under plaintiff's theory, there would be nothing to prevent it from increasing its own surplus or from making appropriations for payment into the surplus of its parent company, merely by debiting depreciation reserve—all this without any control by the Commission unless the Commission could find that such action left the

depreciation reserve as a whole impaired. This would make a mockery of regulatory accounting.

VI

DECISIONS BELIEVED TO SUSTAIN JURISDICTION

National Broadcasting Company et al. v. United States, 316 U. S. 447.

Columbia Broadcasting System, Inc. v. United States, 316 U. S. 407.

American Telephone & Telegraph Co. v. United States, 299 U. S. 232.

It is respectfully submitted that the Supreme Court of the United States has jurisdiction of this appeal and that the questions presented are substantial.

A copy of the opinion delivered by the District Court denying the motion for summary judgment and which is sought to be reviewed, together with the order of the court containing the findings of fact and the decree of the Court is attached to this statement as Exhibit A.

Respectfully submitted.

CHARLES FAHY,
Charles Fahy,
Solicitor General of the
United States of America.

CHARLES R. DENNY,
Charles R. Denny,
General Counsel of the Federal
Communications Commission.

Dated FEBRUARY 24, 1945.

**United States District Court, Southern
District of New York**

Civ. 24-211

NEW YORK TELEPHONE COMPANY, PLAINTIFF
v.

**UNITED STATES OF AMERICA AND FEDERAL COMMU-
UNICATIONS COMMISSION, DEFENDANTS**

Before THOMAS W. SWAN, Circuit Judge, and
JOHN W. CLANCY and JOHN BRIGHT, District
Judges

Ralph W. Brown, Esq., 140 West Street, New
York City; *Frank A. Fritz, Esq.*, 140 West Street,
New York City; *Henry J. Friendly, Esq.*, 31 Nas-
sau Street, New York City; attorneys for New
York Telephone Company.

Honorable *James B. M. McNally*, United States
Attorney for the Southern District of New York,
attorney for the United States of America.

Charles R. Denny, Esq., General Counsel, Fed-
eral Communications Commission, New Post Office
Bldg., Washington, D. C.

BRIGHT, D. J.: Defendants move for summary
judgment on the ground that there is no genuine
issue of fact. Plaintiff asks, at this time, no
affirmative relief.

Jurisdiction is not questioned, and is established by Section 402 (a) of the Commissions Act of 1934, 48 Stat. 1064, 1093, 47 U. S. C. A. Section 402 (a), and by the Urgent Deficiencies Appropriation Act, 38 Stat. 219, 28 U. S. C. A. Section 41 (28) and Sections 46 and 48.

The action is brought to enjoin and annul an order of the Federal Communications Commission dated December 14, 1943, which directed plaintiff to make certain accounting changes in its books, by reducing its surplus by \$4,166,510.57 (the excess of payments by plaintiff to American Telephone & Telegraph Company, which we will call the "American Company," for telephone plant purchased by plaintiff from the latter on November 1, 1925, September 1, 1926, and December 31, 1928, and for telephone instruments so acquired on December 31, 1927) over the amount found by the Commission to represent the net book cost of such acquisitions on the books of the American at the time of such purchase; to restate this investment in plant so acquired; to balance these changes by adding to depreciation reserve \$3,879,957.94; and to make other entries in its accounts.

At the time of these acquisitions, the American Company owned all of the outstanding common stock of the plaintiff. There were also outstanding in the hands of the public 250,000 shares of plaintiff's 6½% \$100 cumulative preferred stock, and in excess of \$132,000,000 of mortgage bonds. All

of plaintiff's officers, and at least two-thirds of its directors, were not directors, officers or employees of the American Company. It maintained its own books and records, and its employees, property and business were separate and apart from those of the American Company.

✓ Prior to 1925 the American Company had furnished intrastate and interstate toll service between certain points in New York. In that year it was agreed that such business would be transferred to plaintiff. In order to accomplish that, plaintiff purchased from the American Company certain toll plant, consisting of tangible property such as poles, wires, serials and underground cable rights of way, etc., as of November 1, 1925, September 1, 1926, and December 31, 1928.

Prior to December 31, 1927, the American Company, as holder of the fundamental Bell patents, owned three small but essential parts of the telephone equipment placed with subscribers by plaintiff. These parts were the transmitter, receiver and an induction coil, and were commonly known as the instruments. On that date the American Company sold to plaintiff the instruments then in service or in the supplies of plaintiff, at a price based upon then average price charged the American Company by Western Electric Company, the manufacturer of the instruments, less an allowance of 20% to reflect the condition of the instruments.

The purchase price for the toll plant was agreed upon as being an amount equal to the cost of

reproduction less deterioration, determined by a field inspection and detailed appraisal; and that of the instruments was approved by qualified engineers of the plaintiff. A tabulation of these purchases as compared with the book cost to the American Company shows:

Total plant	Purchase price	American book cost	American depreciation reserve	American net book cost	Cost of purchase price over net book cost
11/1/25	5,831,884.78	5,010,340.19	801,858.95	4,208,481.24	1,623,403.54
9/1/26	97,310.39	95,924.66	14,449.20	81,475.46	15,834.93
12/31/28	44,246.30	28,077.64	4,144.78	23,932.86	20,313.44
<i>Instruments</i>	5,973,441.47	5,134,342.49	820,452.93	4,313,889.56	1,659,551.91
12/31/27	6,661,238.91	8,135,224.98	3,980,944.73	4,154,280.25	2,506,958.66
	12,634,680.38	13,269,567.47	4,801,397.66	8,468,169.81	4,166,510.57

At the time of these transactions, plaintiff was a telephone company within the meaning of the Interstate Commerce Act and subject to Section 20 of that Act (24 Stat. 379, 386 as amended by 34 Stat. 584, 598, 594), and was prohibited by that section from keeping any other accounts than those prescribed by the Interstate Commerce Commission. That Commission, on December 10, 1912, prescribed a uniform system of accounts for telephone companies, and that system, as interpreted by the Interstate Commerce Commission, by Instruction 10, provided:

10. *Costs to be actual money costs.*—All charges made to fixed capital or other property accounts with respect to any property

acquired on or after January 1, 1913, should be the actual money costs of the property. * * *

Instruction 13 of that system provided, in part:

13. *Plant and equipment and other property purchased.*—When any property in the form of a going or completed plant is purchased, an appraisal of the property so acquired should be made; and the different constituent elements of the plant (and equipment, if any) or other property acquired should be appraised at their structural value; that is to say, at the estimated cost of replacement or reproduction less deterioration to the then existing conditions through wear and tear, obsolescence, and inadequacy. If the actual money value of the consideration given for the plant or other property was at the time of the acquisition in excess of such appraised value, the excess should be charged to account No. 204. Other Intangible Capital, “and the appraised values of the constituent elements should be charged to the appropriate fixed capital accounts as hereinafter designated. If the actual money value of the consideration given was not in excess of such appraised value, such actual money value should be distributed through the said accounts in proportion to the said appraised value of the constituent elements appropriate to the respective accounts. * * *

The accounting bulletin adopted by the Interstate Commerce Commission on June 26, 1916, provided in case No. 30:

Query. What items should be classified as "going or completed plant" under section 13, page 33, "Plant and equipment and other property purchased" of the Uniform System of Accounts for Class A and B companies?

Answer. The term "going or completed plant" is intended to cover only the entire plant of a telephone company or an important unit thereof; such as—

- (1) A telephone company as a whole.
- (2) An entire central office.
- (3) A system of lines and stations within a given area, or
- (4) A complete section of toll plant.

The purchase by one company from another of several poles and appurtenances, a switchboard, or other minor portions of plant shall be treated in the same manner as the purchase of materials and supplies; i. e., the purchasing company shall charge the fixed capital accounts at cost, as provided in section 10, page 33, of the Uniform System of Accounts for Class A and B companies.

Plaintiff, purporting to act under Instruction 13, and treating the acquisition of the plant as coming within case No. 30, distributed the \$5,973.-441.47, which it claimed was the actual cost to it of that property, among its various plant accounts

in the precise amount of appraised structural value of the various types of property purchased; and purporting to act under Instruction 10, recorded the \$6,661,238.91, which it claimed to have paid for the instruments, in the plant accounts.

The Interstate Commerce Commission's system of accounts continued in effect until January 1, 1933, on which date a revised system became effective, which continued in force until January 1, 1937, the effective date of the uniform system of accounts for telephone companies prescribed by the defendant Federal Communications Commission. The revision of the system by the Interstate Commerce Commission as of January 1, 1933, did not require any change by the plaintiff in the accounting which it had performed with respect to the transactions in question.

The Communications Act of 1934 (48 Stat. 1064, 47 U. S. C. A. Sections 51 et seq.) approved June 19, 1934, became effective upon the organization of the Commission on July 11, 1934, except as to Sections 1 and 4 thereof, which became effective on July 1, 1934; and plaintiff was and is engaged in interstate and foreign communication by wire and radio within the meaning of Section 2 of that Act.

Under that Act, the defendant, Federal Communications Commission, is given power to "Make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be neces-

sary in the execution of its functions," § 4 (1); to "At any time require any such carrier (which, by definition in 3 (h) would include this plaintiff) to file with the Commission a statement showing the original cost at the time of dedication to the public use of all or any part of the property owned or used by said carrier. * * * If the carrier owning the property at the time such original cost is reported shall have paid more or less than the original cost to acquire the same, the amount of such cost of acquisition, and any facts which the Commission may require in connection therewith, shall be reported with such original cost," § 213 (e); to prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act," § 220 (a), and under subdivision (c) of the same section, the "burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by any such person." And under subdivision (g), "After the Commission has prescribed the form and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts; records or memoranda than those so prescribed or such as may be approved by the Commission to to keep the accounts

in any other manner than that prescribed or approved by the Commission.

By Section 604 (a), "All orders, determinations, rules, regulations, * * * which have been issued, made or granted by the Interstate Commerce Commission * * * under any provision of law repealed or amended by this Act, or in the exercise of duties, powers or functions transferred to the Commission by this Act, and which are in effect at the time this Section takes effect, shall continue in effect until modified, terminated, superseded or repealed by the Commission or by operation of law."

On June 19, 1935, the defendant Commission issued telephone division order No. 7-G, which prescribed for the plaintiff and other telephone companies, a system of accounts effective January 1, 1936, which differed from both systems theretofore prescribed by the Interstate Commerce Commission. Insofar as we are now interested, this system of accounts prescribed, as to balance sheet accounts and investments, that account 100.1, "Telephone plant in service" shall include the original cost (defined in § 31.01-3 (k) as meaning "the actual money cost of * * * property at the time when it was first dedicated to the public use, whether by the accounting party or by predecessors"); of the company's property used in telephone service at the date of the balance sheet; and Account 100.4, "Telephone plant ac-

quisitions adjustment," should include amounts determined in accordance with § 31.2-21 representing the difference between (1) the amount of money actually paid for telephone plant acquired, plus expense of acquisition and (2) the original cost of such plant less the amount of reserve requirements for depreciation and amortization of the property acquired. "(c) The amounts recorded in this Section with respect to each property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct." Section 21.2-21 relating to telephone plant acquired provided that when substantially complete toll line was acquired from predecessors, and charged to account 276, "Telephone plant acquired," the accounting shall be completed as follows: The original cost shall be charged to the telephone plant accounts as appropriate and credited to Account 276; the reserve requirements for depreciation and amortization shall be credited to Account 171 "depreciation reserve," and Account 172 "amortization reserve," and debited to Account 276; and the amount remaining in Account 276 shall be debited or credited as appropriate to Account 100.4 "Telephone plant acquisition adjustment," with certain exceptions not important here.

The promulgation of this system of accounts was met by an action in which the American Com-

pany and other telephone companies, including this plaintiff, were plaintiffs, and the United States and Federal Communications Commission were defendants, to enjoin and annul the proposed system. The plaintiffs were almost completely unsuccessful in this court (14 F. Supp. 121), and upon appeal, the Supreme Court affirmed, 292 U. S. 232. In this court, the defendants denied that the definition of original cost would require the plaintiffs to restate as of January 1, 1936, their property investment accounts by eliminating therefrom the recorded cost or investment of the plaintiff in property theretofore acquired from another public utility.

The Statutory Court made findings of fact, in part, as follows: V, that the order 7-C does not require that the recorded cost or investment in plaintiff's property theretofore acquired from another public utility be obliterated or eliminated from their investment accounts, but merely requires the plaintiffs to segregate the element of recorded cost or investment into investment accounts 100.1-2-3-4; VIII, that the order does not prevent plaintiffs from recovering amounts included in accounts 100.4 in view of the alternative provisions in paragraph C, and the Commission has made no direction in paragraph C, and the Commission has made no direction with respect to the disposition of any such accounts; XI, that the order does not require plaintiffs to write off

any portion of their actual investment where they had paid in excess of the original cost; XII, does not require plaintiffs to make radical or retroactive changes in their completed accounts, but merely requires the reclassification of balances as of its effective date in certain balance sheet accounts; and XIII, it does not require that amounts recorded in account 100.4 be disposed of, written off, or amortized by plaintiffs, the form of accounting to be performed is dependent upon the development of facts in connection with each individual acquisition. And in the 13th conclusion of law, the lower court found that the order was not retroactive in its requirements.

In the Supreme Court, Mr. Justice Cardozo wrote in part:

The argument is that account 100.4 representing the difference between original and present cost, is not to be reckoned, either wholly or in part, as a statement of existing assets, but must be written off completely. The Commission is charged, we are told, with a mandatory duty to extinguish the entire balance recorded in that account, its presence under the title of "investments" having the effect of a misleading label. To give support to that conception of official duty, they rely on subdivision (c), which provides, as we have seen, that "the amounts recorded in this account with respect to each property acquisition shall be disposed of, written off, or

provision shall be made for the amortization thereof in such manner as this Commission may direct."

If subdivision (c) had the meaning thus imputed to it, there would be force in the contention that the effect of the order is to distort in an arbitrary fashion the value of the assets. But the imputed meaning is not the true one. The Commission is not under a duty to write off the whole or any part of the balance in 100.4, if the difference between original and present *cost is a true increment* of value. On the contrary, only such amount will be written off as appears, upon an application for appropriate directions, to be a ~~fictitious or paper~~ increment. This is made clear, if it might otherwise be doubtful, by administrative construction. * * *

To avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed, we requested the Assistant Attorney General to reduce his statements in that regard to writing in behalf of the Commission. He did this and informs us that "the Federal Communications Commission construes the provisions of Telephone Division Order No. 7-C, issued June 19, 1935, pertaining to account 100.4" as meaning "that amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets

of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provision will be made for their amortization."

We accept this declaration as an administrative construction binding upon the Commission in its future dealings with the companies. * * * The administrative construction now affixed to the contested order devitalizes the objection that the difference between present value and original cost is withdrawn from recognition as a legitimate investment.

We are not impressed by the argument that the classification is to be viewed as arbitrary because the fate of any item, its ultimate disposition, remains in some degree uncertain until the Commission has given particular directions with reference thereto. By being included in the adjustment account, it is classified as provisionally a true investment, subject to be taken out of that account and given a different character if investigation by the Commission shows it to be deserving of that treatment. Such a reservation does not amount to a departure from the statutory power to fix the forms of accounts for "classes" of carriers rather than for individuals. The forms of the accounts are fixed, and fixed by regulations of adequate generality. What disposition of their content may afterwards be suitable upon discovery that particular items have

been carried at an excessive figure must depend upon *evidentiary circumstances*, difficult to define or catalogue in advance of the event. If once there was any need for explanation more precise than that afforded by the order, it is now supplied, we think, by an administrative construction, which must be read into the order as supplementary thereto.

It is to be observed that this case did not decide what power the Commission had other than to order a uniform system of accounts. The order 7-C was clearly found to be within the law as a constitutional and statutory exercise of the powers conferred upon the Commission by the Communications Act of 1934. While appellants in that case complained that the system of accounting might authorize the Commission in the future to do something toward obliterating or striking out the difference between original cost and purchase price, the court refused to adjudicate as to the validity of the system based upon any such anticipated action. It left the determination of that point to be decided upon whatever facts might subsequently be revealed as 'justifying' it. It would seem that the only question here is whether the Commission now has power to direct the debit to surplus and the other charges of which complaint is now made. The other case stopped short of deciding that.

From time to time after the acquisition of the toll plant and instruments, certain units of both

have been retired and written out of the plant accounts at the amounts recorded therein, and the same amount less salvage has been charged to depreciation reserve. Out of the total plant purchased at a cost of \$5,973,441.27, there remained in the plant accounts as of Jan. 1, 1937, toll plant of an estimated book cost of \$2,971,058.99, and as of Jan. 1, 1942, an estimated book cost of \$2,611,586.39. Out of the instruments purchased at a cost of \$6,661,238.91, there remained in the plant accounts as of Jan. 1, 1937, instruments having an estimated book cost of \$2,433,105.41, and as of Jan. 1, 1942, an estimated book cost of \$630,279.13.

Here the accounting practice followed by the plaintiff, at the time of and for a number of years after the acquisition of the toll plant and instruments, was, in our opinion, in conformity with the rules of the Interstate Commerce Commission. Testimony that it did not follow good accounting practice would be immaterial if the practice followed was within the regulations then in force.

When the "original cost" theory was introduced by the Communications Act of 1934, insofar as telephone companies were concerned, a new system of accounting was devised by the Federal Communications Commission which required for the first time the segregation of the so-called "profit" into an account other than that in which original cost was entered. At that time some portion of

the toll plant and instruments had been retired. The right to make the segregation was attacked in the A. T. & T. case, one of the reasons given being that because segregation was required, the difference between original cost and the alleged price "must be written off completely * * * the Commission is charged * * * with the mandatory duty to extinguish the entire balance recorded in" account 100.4 pursuant to subdivision (C) of that accounting requirement. Mr. Justice Cardozo answered that as above quoted.

The administrative construction referred to, and plainly appearing in the stipulation then filed by the counsel for the Federal Communications Commission, is not present in any of the other cases to which our attention has been called; and in this case, for that reason, if for no other, is clearly to be distinguished from those cited. That administrative construction, if none other, it seems to us, precludes the action now taken until (1) there has been a "fair consideration of all the circumstances", and (2) unless the difference between the original and present cost is not "a true increment of value" but is a "fictitious or paper increment"; and action to obliterate must depend upon "evidentiary circumstances" later to be developed.

Here there has been no determination whether the difference between original cost and the price claimed to have been paid is a true increment of

value, unless it is the arbitrary determination that it cannot be because it is the result of a transaction between a parent and an affiliate. There might be real doubt to make such a determination if based upon any such theory. *New York Edison Co. v. Maltbie*, 244 App. Div. 685-689, aff'd 271 N. Y. 103.

The order under review proceeds upon the theory that plaintiff's accounting in question was improper when made and should be corrected. In our opinion the entries made at the time of the four transactions in question accorded with the system prescribed by the Interstate Commerce Commission. They were recorded at "actual money costs", and we do not understand that the fairness of the appraisals then made is questioned. Defendants' position is that the fairness of the appraisals is immaterial because in transactions between affiliates the transferee is bound to take the transferor's net book cost. But if the entries were correct when made, as we now determine, the defendant Commission, under the present record, cannot apply retroactively a new system to write down the plaintiff's surplus. *Arizona Grocery v. Atchison Ry.*, 284 U. S. 370-389.

That this is so seems all the more true in view of the stipulation of these same defendants made in *A. T. & T. v. U. S.*, *supra*; certainly in the absence of proof that the excess of price over the seller's net book cost was not a "true increment of value". There has not been any determination

based upon a fair consideration of all the circumstances in accordance with the stipulation mentioned, nor upon the evidentiary circumstances referred to in the opinion of the Supreme Court.

The motion for summary judgment is, therefore, denied.

Dated: August 24, 1944.

THOMAS W. SWAN,
U. S. Circuit Judge.

JOHN W. CLANCY,
U. S. District Judge.

JOHN BRIGHT,
U. S. District Judge..